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C O N F I D E N T I A L SECTION 01 OF 05 TOKYO 000555

SIPDIS

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PARIS FOR USOECD

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [JA](#)

SUBJECT: JAPAN POST'S PRIVATIZATION: DEALING WITH THE NEXT  
STEPS

REF: A. 07 TOKYO 2716  
[1](#)B. 07 TOKYO 4658  
[1](#)C. 08 TOKYO 3315  
[1](#)D. STATE 3451  
[1](#)E. TOKYO 176  
[1](#)F. TOKYO 295  
[1](#)G. TOKYO 335  
[1](#)H. TOKYO 387

Classified By: Charge James P. Zumwalt for reasons 1.4 b/d.

#### Summary

[1](#)1. (SBU) Seventeen months into the ten-year privatization of Japan Post -- whose operations included mail delivery, the world's largest bank, and Japan's biggest insurer -- a major milestone is coming into view. The initial public offerings (IPOs) of Japan Post Bank and Japan Post Insurance could occur as early as 2010. Ongoing preparations for the IPOs are highlighting sometimes conflicting U.S. interests in the process. To manage the issue effectively, the Embassy believes we need to address specific questions arising from the IPO preparations and refine our core message. End summary.

#### Privatization Process Underway

[1](#)2. (SBU) On October 1, 2007 Japan Post, a government-run corporation with around \$3 trillion in banking and insurance assets, 24,800 post offices, and 260,000 employees began a ten-year process of privatization. It was split into six entities: a holding company; new insurance, banking, delivery, and postal service entities directed by the holding company; and a bridge "successor corporation" for holding pre-existing, government-guaranteed savings deposits and insurance contracts. According to the postal privatization laws passed in 2005, the GOJ must sell all of its stock in the insurance and banking entities within a ten-year period, as well as two-thirds of its stock in the holding company, leading to the full privatization of the insurance and banking operations and the partial privatization of postal delivery and service units.

13. (SBU) Seventeen months into that ten-year process, a major milestone is coming into view: the Japan Post Holding Corporation is eyeing initial public offerings (IPOs) for Japan Post Insurance and Japan Post Bank as early as 2010. The date can be postponed; timing of the IPOs will depend on a number of factors, including prevailing economic conditions, the stock market, and the postal institutions' internal transformation. Nevertheless, preparations are underway.

14. (SBU) The GOJ has a significant economic incentive to bring the postal financial entities to market as quickly and as profitably as possible. At nearly 180 percent, the ratio of government debt to GDP is the highest among OECD countries, and the greater the market valuation of those entities' public offerings, the more resources Japan's government will have at its disposal to reduce its debt burden or increase its fiscal outlays.

#### Weighing U.S. Interests

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15. (SBU) Japan Post's privatization presents economic and political reform opportunities (ref A), but also poses potential concerns for U.S. interests. Those interests include ensuring U.S. companies are not disadvantaged competitively during the transition, improving Japanese regulation of the postal entities, and fostering a successful privatization.

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16. (SBU) Simply put, it is not in the U.S. interest for the privatization to fail. A failure of the privatization -- or even a Japanese perception of failure -- would discourage reform of other Japanese state-owned institutions and set back the long-term restructuring necessary for Japan to revitalize its economy and play a role as a global partner of the United States. A failure of or freeze in the privatization process could also put U.S. companies into a nightmare scenario: long-term competition with wholly government-owned entities whose pre-privatization legal restrictions on expansion have been lifted, but which are not subject to the full demands of a private sector existence.

17. (SBU) Recent preparatory actions by Japan Post Insurance to apply for a new cancer insurance product license (refs D-H) highlight the risks to U.S. companies. Insurance industry representatives report robust Washington and Embassy advocacy appears to have stalled Japan Post Insurance's application. However, the issue has only receded temporarily and will almost certainly reappear within the year.

18. (C) The USG has long held the position the postal financial entities should not be allowed to offer new or altered products until equivalent conditions of competition are established between the postal bank and insurer and their private sector competitors. With equivalent conditions of competition enshrined as a principle in Japan's postal privatization laws, and (until now) with the IPOs years in the future, that message has served well to guide advocacy efforts. However, with the coming IPOs moving to the front of the privatization timeline, that straightforward and conceptual standard has become more difficult to maintain. Embassy Tokyo therefore believes a refined interagency position is needed to manage postal privatization effectively.

#### Key Issues

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19. (C) For some issues, the path forward is clear. Ensuring Japan Post Bank and Japan Post Insurance are held to the same regulatory standards as private companies, for example, not only eliminates the Japanese postal companies' unfair competitive advantages but strengthens the soundness of Japanese market regulation. Similarly, eliminating cross-subsidization between postal entities simultaneously

removes a competitive concern and increases regulatory transparency. In the longer term, improving the transparency and soundness of regulation should contribute to the success of the postal entities' IPOs and broader postal privatization.

¶10. (C) For other issues, U.S. interests can be more conflicted. The most pressing example revolves around whether government ownership of Japan Post Bank and Japan Post Insurance constitutes an unfair competitive advantage and therefore should preclude the approval of new products prior to their IPOs. Technically correctly or not, Japanese regulators and the Postal Service Privatization Committee (PSPC), a quasi-governmental body of experts that guides the postal privatization process, have characterized the issue as a question of whether government ownership confers an "implied government guarantee" on Japan Post Bank and Japan Post Insurance.

¶11. (C) For some Japanese officials, the issuance of new products speaks to the very success of the privatization process itself. Those officials argue Japan Post Bank and Japan Post Insurance must demonstrate the ability to launch new products prior to their IPOs to show market analysts they can operate like private companies. If the postal entities are not allowed to show their potential for generating profits in the future, they assert, the entities' will be undervalued in their IPOs, with negative fiscal and political ramifications for the Japanese government.

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¶12. (C) In contrast, a senior U.S. insurance industry representative in a private exchange with emboffs recently floated the idea that Japan Post Bank and Japan Post Insurance should not have their IPOs until shortly before the ten-year privatization period ends in 2017. He argued the entities' competitive advantages stemming from government ownership will not disappear until the GOJ has completely divested its shares and that the postal entities should therefore not be allowed any new or altered products in the next eight-and-a-half years.

¶13. (C) Finally, there are issues that bear on whether equivalent conditions of competition have been achieved -- and therefore whether new products should be approved -- but that are the unique legacies of postal privatization and that likely cannot be changed without reformulating the laws underlying the process. The re-insurance contract between Japan Post Insurance and the "successor corporation," which provides a revenue stream to Japan Post Insurance from its pre-privatization business, is one example. The modified way in which Japan Post Insurance received its insurance license is another. Only judgment can resolve whether those features fall outside "equivalent" competitive conditions, because barring changes to the underlying legal framework, they will remain in place throughout the ten-year privatization period. The re-insurance contract, for example, will disappear only when the last policyholder of a pre-privatization product dies -- decades from now.

#### Domestic Politics Again a Factor -----

¶14. (C) Complicating the situation is an accelerating re-politicization of postal privatization. Liberal Democratic Party (LDP) politicians are increasingly involved in what had become a largely technocratic process after the 2005 "postal" Lower House election. Even though in 2007 former PM Abe re-instated several "postal rebels," whom Koizumi had ejected from the party for their objections to the privatization, Abe insisted they pledge to support privatization as a condition of their re-admittance to the party. That insistence appears to have kept the issue submerged during Abe's and former PM Fukuda's terms, but political intervention in the privatization has surfaced more and more under PM Aso.

¶15. (C) For example, Aso muddied the waters with controversial comments on the postal entities' IPOs in November 2008. Minister of Internal Affairs and Communications (MIC) Kunio Hatoyama subsequently announced he would block the planned sale of Japan Post property, pilloried Japan Post Holdings Company management for its plans to redevelop Tokyo's historic central post office, and reportedly suggested to a Diet committee what kinds of product applications Japan Post Bank and Japan Post Insurance should develop. Aso jumped in again in February, announcing he had been opposed to privatization at the time PM Koizumi pushed its enactment. He then back-tracked, provoking both pro- and anti-reform members of the ruling party.

¶16. (C) Despite some recent public actions by former PM Koizumi to support his signature reform, it is unclear which direction the current LDP leadership will take. Late in 2008, an LDP project team was appointed to review privatization and seek compromises that would mitigate intraparty conflict. The team recently submitted a paper to the PSPC in advance of its three-year review of privatization. Although the paper reportedly avoided major recommendations to alter the structure of privatization, media sources suggest it did include specific recommendations that Japan Post Insurance and Japan Post Bank be allowed to market new cancer insurance and loan products.

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¶17. (C) If prospects for postal privatization are uncertain under the LDP now, an opposition Democratic Party of Japan (DPJ) victory in the coming Lower House election could throw the process into disarray. The DPJ depends on a voting block with the small People's New Party (PNP) to control the Upper House, and the PNP's one real issue is opposition to postal privatization. The DPJ, therefore, has backed a bill to "revise" or "freeze" postal privatization four times since 2007 (ref B).

#### Next Steps

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¶18. (C) Three near-term events will suggest the direction postal privatization will move over the next year. First, the term of PSPC members ends March 31. Naoki Tanaka, a long-time think tank expert and close associate of reformist, former PM Koizumi, has chaired the PSPC. Who is chosen to succeed him and his colleagues could speak volumes about further political intervention in the privatization.

¶19. (C) Second, the PSPC is slated to release its three-year review of postal privatization around the end of March or beginning of April. The PSPC has solicited opinions from stakeholders for months, including from U.S. industry, and also received the LDP project team's report. Summary minutes from a recent PSPC meeting indicate the three-year review may recommend the Financial Services Agency (FSA) and MIC consider government ownership of the postal entities as not constituting an unfair competitive advantage when assessing new product applications.

¶20. (C) Third, given Japanese perceptions the postal entities must develop new products to enhance their IPO values, Japan Post Insurance is unlikely to abandon plans to apply for a new product license. No one knows when it might submit an application, but the time required to secure a license and roll out a product means the postal insurer would likely start the process at least a year prior to an expected IPO.

¶21. (C) Developments at the PSPC or a new product application could therefore present challenges to U.S. interests over the coming months. Long-term we will want to manage those challenges to avoid 1) a stalled process where Japan Post Bank and Japan Post Insurance are issuing new products, but remain government-owned; and 2) a failed process that discourages further reform.

¶22. (C) In the short-term, we will most likely need to deal with the question of government ownership and its relationship to approvals to new products. What we want to avoid is finding ourselves at an impasse over new product applications that creates prolonged bilateral tensions with negative fallout, no apparent exit, and heightened chances of either a stalled or failed process. One of our key tasks, therefore, is to weigh the acute competitive concerns of U.S. firms against the long-term threats of a stalled or failed privatization.

¶23. (C) One possibility in considering next steps is the formulation of more specific, graduated measures we expect Japan to implement in its efforts to establish equivalent conditions of competition, including (or not) the postal entities' IPOs. Another would be to play for time while political support for the overall process shakes out. A third might be encouraging the postal entities to focus their energies on new product development in areas that do not directly compete with U.S. firms.

¶24. (C) Our long-held position that the postal entities should not be allowed to issue any new or altered product prior to the establishment of equal competitive conditions

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has guided advocacy well, but it may be time to refine the message. Without an interagency decision on what constitutes equal competitive conditions (particularly with regard to government ownership of the postal entities), we are less and less able to chart a course through this difficult and important topic that both properly balances U.S. interests and manages the expectations of our Japanese counterparts and other stakeholders.

ZUMWALT